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Antitrust Guideposts for B2B Electronic Marketplaces

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B2B COMMENTARY

Antitrust Guideposts for B2B Electronic Marketplaces

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ANTITRUST MAGAZINE'S DEDICATION of this issue to business-to-business electronic marketplaces (B2Bs) could hardly have been more timely. B2Bs connect businesses via the Internet, and they exemplify both how technology enables business to collaborate in new ways and how the impulse to collaborate drives development of new technology.

As this issue of ANTITRUST demonstrates, there is immense anticipation of how antitrust law will address the questions B2Bs pose. Businesspeople, legal scholars, technologists, economists, and others who know the B2B terrain debated many potential antitrust issues during the Federal Trade Commission's public workshop on B2Bs in June 2000,[1] and the staff of the FTC issued a report in October 2000 discussing the issues addressed during the workshop.[2] This article reflects and draws on that discussion.

B2Bs can become impressive engines of efficiency and competition, dramatically reducing costs and even making some markets more competitive. B2Bs are not, of course, immune from anticompetitive concerns, but they can be set up and run so as to minimize their antitrust risk. Toward that end, we highlight some of the key concerns that may arise while counseling B2Bs or their participants. We raise more questions than we answer, but in so doing we outline some of the antitrust issues that may arise.

Basics of B2Bs

At the heart of B2B electronic marketplaces is technology that promotes new methods of communication between businesses. That communication, in turn, facilitates new relationships between businesses. Many buyers and sellers now deal with each other by phone or fax, or perhaps via electronic data interchange (EDI) systems. But phone and fax transactions can lead to costly clerical errors, and EDI systems are somewhat limited and definitely expensive.

The Internet has made it less expensive for buyers and sellers to connect with each other: more firms can more readily access each other, and once connected, they can send more and more content to each other quickly. In short, Internet-based communications have permitted the recent explosion of B2B electronic marketplaces.

Do competitors have to collaborate, via B2Bs, to capture the efficiencies of trading on the Internet? The answer is not yet clear. Rather than participate in B2Bs, some companies are choosing to benefit from the Internet through establishing their own private network for communications with their suppliers.

But for the countless businesses forming or considering forming B2Bs, these online business collaborations are incredibly diverse. As was immediately apparent at the FTC workshop, both the structure and function of B2Bs reflects a multitude of factors beyond technology. Those factors include which goods are traded, what pricing mechanism is used, and how the B2B is organized. We outline each in turn.

Goods Traded. B2Bs serve a broad array of industries, from metals to produce to chemicals to energy to engineered goods. B2Bs can be used to buy and sell everything from indirect goods, like pens and janitorial services, to direct goods, like the motors that a B2B buyer installs into the machinery it manufactures. B2Bs can be used to trade goods which have offline marketplaces. B2Bs can be used to purchase though long-term contracts, such as for custom-made electronics devices, or on an ad-hoc basis, such as for bulk chemicals to cover an unexpected shortfall. Moreover, B2Bs can provide a marketplace for goods that might not otherwise have a viable sales channel. For example, a B2B can match those looking to have small loads hauled with trucks having excess capacity and heading their way.

Pricing Mechanisms. Likewise, B2Bs can establish prices in a variety of different ways: by catalog, by a bid-ask system, by auction, or by other means. While the technology enables online prices to be set in a manner closely related to their offline counterparts, the implications of a pricing mechanism for competition may differ between online and offline.

Both online and offline catalogs enumerate the details of the goods for sale. Being online, however, allows the creation of metacatalogs that aggregate entries for a single item from multiple competitors and thus facilitate price comparisons.

Similarly, a bid-ask system, whether online or offline, involves the matching of orders and quotes in circumstances

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where prices can move up or down. But for some commodities, it is the ability to trade at "Internet speed" that makes a bid-ask system a viable option.

Auctions assume as many forms online as they do offline. For example, forward auctions involve buyers bidding against one another to purchase a good for sale. Prices move up. Reverse auctions involve competitive bidding by suppliers to sell goods to buyers. Prices move down. Online auctions, however, may include firms participating from locations all over the globe; the reduced relevance of geography in online auctions makes them more attractive for many businesses.

Organization. Finally, organizational structures vary among B2Bs. Sometimes B2Bs are owned by companies that plan to trade on them ("consortium B2Bs"); sometimes they are founded by third parties who do not plan to buy and sell on them; and sometimes they are founded by a blend of the two. The implications are important. For example, some of our workshop panelists stated that ownership interest by industry participants is necessary to ensure that a B2B has sufficient liquidity and sufficient funding for the development of software, functionality and the like. Others disagreed and stated that ownership by non-industry participants is essential to a B2B functioning in a fair and neutral manner.

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Antitrust and B2Bs

Competition is just as important in the burgeoning online marketplaces and in the product markets they serve as it has always been in the offline world. Indeed, the centrality of ensuring a competitive marketplace was a key point of agreement among many of the panelists in the FTC's B2B workshop.

Many panelists agreed that B2Bs pose familiar, though sometimes difficult, antitrust questions. The real test is how to apply the law to the new facts this emerging technology creates. Do B2Bs permit information-sharing among rivals, and if so, what information and under what circumstances? Do they facilitate joint purchasing at market share levels high enough to raise concern? Do they exclude the rivals of their owner-participants, and if so, under what circumstances? Do they compel participants to forsake rival B2Bs?[3]

The starting point of the analysis are the Antitrust Guidelines for Collaborations Among Competitors, which the FTC and the Department of Justice issued jointly in April 2000.[5] Those guidelines state, in general terms, the Agencies' approach to analyzing competitor collaborations. These guidelines, standing alone, do not provide all of the answers. Antitrust analysis is by its very nature heavily fact-dependent, and each B2B will present its own unique set of circumstances for analysis. Nonetheless, the general contours of electronic marketplaces are sufficiently well-established that certain lines of inquiry suggest themselves.

Information Exchange

Information exchange among B2B buyers or sellers could promote competition and efficiency in the markets for the goods bought and sold in B2Bs. By reducing search costs, B2Bs can help buyers save money by making it easier to handle more bids more quickly, to comparison-shop, or to find more suppliers. They can likewise help sellers by providing greater and cheaper access to more potential customers. In B2Bs where catalogs aggregate prices and other information, buyers can, with a few mouse clicks, compare the prices of several vendors of a given product. In some B2Bs that host reverse auctions, a buyer can invite sellers across the globe to bid against each other for its business; likewise, sellers can auction off used machinery in B2Bs that allow them to reach more potential buyers than before. This greater price transparency can greatly enhance competition in the market for goods traded on the exchange, and result in lower prices for consumers.

Likewise, B2Bs can dramatically reduce the administrative costs of buying and selling between businesses. The current phone and fax method that some firms use takes its toll both in terms of time and accuracy. Internet-based transmission of such deals can dramatically reduce both costs. In fact, decreasing administrative costs may be the most immediate and pervasive effect of B2Bs.

Moreover, B2Bs have the potential to let suppliers all along the supply chain know what the buyer wants and when, reducing inventory costs and delays. The process can become even more streamlined for those businesses with enterprise resource planning systems, which may be connected to a B2B so that the buyer's internal inventory system can more seamlessly convey its needs as they arise. This, too, could result in benefits for consumers.

However, information-sharing agreements among buyers or sellers might facilitate anticompetitive coordination on price or other matters. Firms in a concentrated industry generally "know that stable high prices, maintained by all firms, would benefit [them] all."[5] But uncertainty about what each other is actually doing can frustrate attempts to set such stable high prices. How is a firm to know that its price-hiking move has been noticed by its rivals, so that they can follow suit? How can a firm know that its rivals are sticking to the pricing arrangement, and not "cheating" by selling at a lower price?

Firms can overcome such uncertainty through certain kinds of information-sharing agreements,[6] and participants in our workshop expressed concerns that B2Bs could become the vehicles for such information-sharing agreements. For example, could B2Bs seller-owners in a concentrated market agree to share information about what they are charging, and could that lead to their tacit collusion on price? Could buyer-owners agree to share through the B2B enough information about their purchases of inputs to lead to tacit collusion on the prices they charge for their outputs, or on the quantity of outputs that they produce? Tacit collusion on other matters might become easier too. One group of suppliers, for example, has stated that a B2B's buyer-owners could agree to share information through the B2B about transaction terms such as "payment options, payment dates, financing terms, and perhaps even warranties," an agreement that could lead to the "standardization" of those terms.[7]

Only a look at the facts of a particular B2B can determine whether its information-sharing agreements are likely to facilitate such collusion, but in doing so, counselors may wish to consider certain key factors, none of which is alone dispositive:

Who is sharing the information? Is the information being shared among competitors or non-competitors?

What type of information is being shared? As the Competitor Collaboration Guidelines point out, "[o]ther things being equal, the sharing of information relating to price, output, costs, or strategic planning is more likely to raise competitive concern than the sharing of information relating to less competitively sensitive variables."[8] Is the shared information merely the sort of data that is already available outside the B2B? If so, could it be discovered offline as quickly and easily as through the B2B?

How old is the information? All other things being equal, sharing contingent or future pricing information is generally more troubling than sharing information about past transactions.[9] The enforcement agencies have encountered such a situation in the past: In 1992, the Department of Justice charged that some airlines used a fare dissemination system to collude through a complex scheme that allowed them to exchange future fare and other information.[10] Shared information about instantaneous transactions can also raise antitrust concerns; for example, frequent, small-stake online auctions may allow bidders to adjust their future bids strategically.

The competitive impact of such inquiries may depend on whether the markets the B2B serves are susceptible to collusion. How concentrated is the relevant market? What share of the market is controlled by the information-sharers? All other things held equal, competitive concerns are greater where the degree of market concentration, or the share of the market controlled by information-sharers, is greater. Thus, shared information relating to direct goods is generally more likely to generate antitrust concern than shared information relating to indirect goods. This is because the information-sharers are less likely to dominate the markets for indirect goods, like office supplies, which many other companies buy. How high or low are the entry barriers? How homogeneous are the products or firms within the market? How advantageous would it be for a firm to cheat on a price-fixing deal? Answers to such questions help determine whether the market is generally susceptible to collusion in the first place.[11]

If the shared information at issue appears to have the potential to facilitate collusion in a relevant market, the question becomes whether the B2B is choosing to allow information to be shared because there are important efficiencies at stake. Could firewalls or other measures such as the masking of select information preserve those efficiencies and eliminate or at least reduce the collusion risks? Our workshop participants proposed a number of possible measures to address information-sharing concerns. For example, a B2B may keep certain information away from certain participants in online auctions or catalogs, employ nondisclosure and confidentiality agreements, keep sensitive information from board members or other B2B workers employed by B2B participants, have their operating rule compliance audited, or exact penalties for the violation of B2B operating rules.

Exclusivity

Just as information sharing and group buying could affect the markets for goods traded on B2Bs, exclusivity practices—practices that "keep insiders in" a B2B—could threaten or enhance competition among the B2Bs themselves.

It is easy to see why a B2B would want to attract participants to itself and keep them there. First, B2Bs need enough trading volume to cover their costs. Second, buyers generally want to trade on an exchange that allows them to reach the most sellers in their market, and vice versa. Such network effects, combined with the need for B2Bs to cover their costs, have the potential to tip the market in favor of a reduced number of marketplaces. The race to get the necessary volume can be particularly keen now as B2Bs are forming. Newly forming B2Bs often find themselves in a crowded field, and they must show their participants (and financial backers) that they will indeed attract and keep enough volume to survive.

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These factors heat up the race for volume, encouraging some B2Bs to employ exclusivity strategies designed to attract and keep participants. Some lure buyers and sellers with positive inducements to promote participation—or "carrots"—such as offering equity interests, rebates, or revenue-sharing in exchange for volume. For example, by offering their founders equity in the exchange, a consortium B2B may give those founders a financial incentive to bring their volume to the exchange. In addition to such "carrots," B2Bs may also brandish "sticks," or disincentives designed to deter participants from leaving. These include minimum volume or other requirements, restrictions on participation or investment in other B2Bs, and "benign coercion," the term one workshop panelist used to describe the pressure that a B2B's strong backers exert upon their trading partners to induce participation in the B2B. (The line between sticks and carrots is a fine one at best, since an inducement can sometimes shade into a threat, and vice versa.) These practices impose switching costs; they exact penalties or withhold benefits if a buyer or seller uses another B2B.

Exclusivity practices may well be procompetitive in the right circumstances. Indeed, some workshop panelists stated that such practices may be reasonably necessary to persuade investors that a new-entrant B2B will attract and keep enough trading volume to be viable.[12] And B2Bs that win volume for themselves on their merits are laudable.

But a competitive concern arises when a B2B uses exclusivity tactics—and not its merits—to attract almost all the volume and leave too little for any rival marketplace to survive. Under that extreme worst-case scenario, the market for a particular good could be dominated by a single B2B, which might then abuse its market power. It might then charge more, offer fewer services, or cease innovating and improving its service without a competitive spur from other marketplaces.

In short, exclusivity practices can be procompetitive or anticompetitive, depending on the factual circumstances. The Staff Report sought to identify a few analytical guideposts: "All else held equal (including the ability to achieve efficiencies and innovations), competitive concerns are magnified (i) the greater the market share of the B2B owners; (ii) the greater the restraints on participation outside the B2B; and (iii) the less the interoperability with other B2Bs. . . . On the other hand, all else held equal (including the level of likely anticompetitive harm), competitive concerns are reduced the greater the contribution of exclusivity to achieving procompetitive benefits."[13]

Exclusion

Another set of problems may arise if a B2B's owner-participants can exclude or discriminate against their rivals so as to raise the business costs of those excluded rivals and gain for themselves the power to raise the price of goods for consumers. Under this scenario, concerns about exclusionary practices—practices that "keep outsiders out" of that B2B—may arise. Such practices have the potential to affect competition, for good or for ill, in the markets for goods traded on the B2B.

Excluding firms from a B2B may sometimes make sense. Excluding companies with poor credit, for example, may be a helpful way to minimize the risk that buyers on the exchange will fail to pay.[14]

On the other hand, such practices can be used to undermine competition as well. Is the seemingly legitimate exclusionary practice a cover for exclusion on improper grounds? Is it a way for the participants in a dominant B2B to exclude buyers or sellers who compete with them? An excluded rival may also find itself locked out of doing business with suppliers or customers who are committed to participating exclusively on that B2B. Even if the B2B's participant-owners let those competitors in, will they do so on discriminatory terms that make it harder for the rivals to provide real competition? For example, will the B2B's participant-owners set up the B2B in a way that biases the computerized display of information in their favor? This has appeared in earlier forays into electronic commerce: computerized reservation systems owned by various airlines originally "display[ed] flight information in a way that favor[ed] the vendor airline . . . by listing their flights above better flights," artificially inflating their desirability.[15]

Whether a B2B's participant-owners can do this, of course, depends on a number of factors. Will the B2B's participants actually have the power to substantially raise the costs of excluded rivals? Can the product, or adequate substitutes for it, be traded comparably elsewhere, online or off? Will new marketplaces arise, giving excluded rivals a place to trade? And if the B2B's participants do have the power to substantially raise excluded rivals' costs, what effect will such higher costs have on competition in the downstream market? Counselors concerned about such issues may wish to examine, among other things, the proportion of each market that the B2B affects, whether adequate substitute services are or would be available through other marketplaces, unique characteristics of the excluded firms, and the state of competition in downstream markets. Counselors may also wish to examine whether and when efficiencies support the exclusionary practices.

Group Buying

Finally, some B2Bs may permit buyers to save money by buying inputs for their products as a group. Such group buying has the potential, depending on the circumstances, to enhance efficiencies or threaten competition in the markets for goods traded on the B2B.

In some cases, buyers can save money by purchasing inputs as a group via a B2B because their collective, high-volume buy saves the seller money, savings the seller can pass on to the buyers. For example, B2Bs may offer joint purchasing that could force down prices through efficiencies like reduced paperwork, better planning, or more efficient shipment of the goods they are buying.

Used improperly, however, joint purchasing can be a tool for monopsony, the abuse of market power by buyers. Under classical monopsony theory, buyers with market power may, under certain conditions, lower the prices they must pay by limiting their purchases. This can reduce output below competitive levels. Buyers who jointly buy through B2Bs and who exercise such monopsony power may well raise competitive concerns.

It is not likely that buyers will have such monopsony power in markets in which they buy only a small fraction of the goods. For this reason, when buyers jointly purchase indirect goods that many other buyers purchase—say, pencils—it typically raises fewer concerns than their joint purchasing of direct goods—say, specialized machinery—that the joint purchasers buy more than anyone else. Does the B2B create buyer power by letting buyers jointly decide what they plan to buy? Such coordination could be done expressly, through an agent, through consulting services, or through any other feature that lets buyers coordinate their purchases with each other. (Such information sharing could also facilitate collusion among buyers, as noted above.)

Counselors concerned about monopsony may wish to consider whether new buyers would be likely to enter and alleviate the problem, and whether safeguards should be adopted to keep monopsony concerns at bay. Workshop participants discussed plans to keep the market share of the buying group low or to limit the flow of information among buyers in the group, for example.

Conclusion

The competitive impact of B2Bs is yet unclear. These are formative times for B2Bs, and for that reason alone, the questions above are more easily posed than answered. Yet practitioners who are attentive to these antitrust issues during this early stage of B2B development may serve their clients well. For our part, we will continue to listen to industry, counsel, and others about the dynamics of B2Bs in order to learn from them about the competitive effects of B2B marketplaces. ▮

1 Materials from the Federal Trade Commission's public workshop, *Competition Policy in the World of B2B Electronic Marketplaces* (June 2000), are available at www.ftc.gov/bc/b2b/index.htm.

2 The authors helped organize and moderate the June 2000 FTC workshop on B2Bs and helped draft the Staff Report from the workshop. The Staff Report is available at www.ftc.gov/os/2000/10/b2breport.pdf.

3 The issues addressed here are those discussed most extensively by the workshop panelists.

4 Federal Trade Commission and U.S. Department of Justice Antitrust Guidelines for Collaborations Among Competitors, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,160, *available at* www.ftc.gov/os/2000/04/ftcdojguidelines.pdf [Competitor Collaboration Guidelines].

5 Clamp-All v. Cast Iron Soil Pipe Institute, 851 F.2d 478, 84 (1st Cir. 1988) (Breyer, J.).

6 *See generally* Competitor Collaboration Guidelines, *supra* note 4, § 3.31(b).

7 See Original Equipment Suppliers Association, Prepared Comment at 7 (submitted in connection with FTC B2B Workshop), *available at* www.ftc.gov/bc/b2b/comments).

8 Competitor Collaboration Guidelines, *supra* note 4, ¶ 3.31(b).

9 *Id.* ("Similarly, other things being equal, the sharing of information on current operating and future business plans is more likely to raise concerns than the sharing of historical information.").

10 *See, e.g.*, United States v. Airline Tariff Publishing Co., 58 Fed. Reg. 3971 (1993) (Jan. 12, 1993) (Proposed Final Judgment and Competitive Impact Statement). The case settled through consent decrees that, among other things, prohibited dissemination of fares that were intended only to communicate planned or contemplated fares or contemplated fare changes. See United States v. Airline Tariff Publishing Co., 836 F. Supp. 9 (D.D.C. 1993) (settlement with two defendants); United States v. Airline Tariff Publishing Co., 1994 WL 502091, 1994 WL 454730 (D.D.C. 1994) (settlement with remaining defendants).

11 *See generally* Competitor Collaboration Guidelines, *supra* note 4, § 3.33.

12 Other possible efficiencies attained by exclusivity practices are found in the Staff Report, *supra* note 2, Part 3.B.4.

13 *Id.*

14 *See also* Staff Report, *supra* note 2, Part 3.A.3 (discussing prevention of free-riding as another possible efficiency of exclusion).

15 *In re* Air Passenger Computer Reservations Systems Antitrust Litigation, 694 F. Supp. 1443, 1450, 1474 (C.D. Cal. 1988), *aff'd*, 948 F.2d 536 (9th Cir. 1991).